



**National Association
for the Self-Employed**

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“Electronic Payments Tax Reporting: Another Tax Burden for Small Businesses.”

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On behalf of our 250,000 member businesses, I would like to thank the Chairwoman Velazquez and Members of the Committee for allowing the National Association for the Self-Employed (NASE) the opportunity to speak with you today regarding the proposal to expand information reporting by requiring credit and debit card issuers to report business owners' annual electronic payment transactions to the IRS. This is just one of the many alarming tax gap recommendations which would increase tax regulation on small business.

The micro-business and self-employed members of the NASE are the segment of the business population that repeatedly struggles to comply with our complex and ever-changing tax code without the benefit of professional assistance. According to a 2005 study by the Tax Foundation, individuals, businesses and nonprofits spent an estimated 6 billion hours complying with the federal income tax code, with an estimated compliance cost of over \$265.1 billion. Businesses bear the majority of tax compliance costs, totaling nearly \$148 billion or 56 percent of total compliance costs. Despite their difficulties, our members understand the importance of tax compliance and support efforts to improve our system. In addition, they believe that those who willfully do not fulfill their tax responsibilities should be penalized.

However, the NASE and our members have become concerned that the zeal of Congress to find funding in our strict budget climate has shifted the delicate balance between what is reasonable and what is detrimental to the latter. The electronic payments tax reporting recommendation is a prime example of this shift. We feel that the current proposal is likely to have significant unintended consequences. As they say "the devil is in the details" and this proposal lacks clear details regarding its implementation which must be brought to light to accurately gauge its affect on both the micro-business community and our economy.

Use of Data

One of our chief concerns with increased information reporting on electronic payment card transactions is the use of the data to be collected by the IRS. There has been no clear indication of how this information would facilitate tax compliance. The IRS has suggested that the data could be utilized to create industry profiles, taking the total credit card receipts reported for a particular business sector and then extrapolating this information to create industry averages. These new industry profiles stemming from credit card receipts could then be used by the IRS to make judgments regarding other items on the tax return such as estimations on cash payments. If this is the intended use of the data, problems will arise. Our association does not support the use of any collected data for this purpose.

NASE member **Mark Harrison** is the owner of The Framing Alternative in York, Maine. About 80 percent of his business is credit and debit card transactions. He says that the proposal "seems very costly and irrelevant." In his opinion, the differing demographics of individual

businesses will make accurate industry profiles impossible and only unnecessarily hurt the self-employed.

We fully agree with Mark. Use of these averages will only provide discrimination against those businesses that have higher than average credit card receipts. This higher average could be a function of the affluence of their community, regional disparities, an owner's efforts in managing cash flow and even the decision of the business on whether to accept a particular credit card. It will be very difficult to determine a relevant, applicable average for a particular small business sector. Therefore, any action taken by the IRS based on these profiles such as examinations, requests for additional information or even tax assessments would be both burdensome to micro-business and most importantly, could be negligent.

Verification and Withholding

The Taxpayer Identification Number (TIN) verification process and backup withholding required of credit and debit card issuers under this proposal is also ripe for mishandling. The proposal requires credit and debit card issuers to verify the TIN of a business. If this information is inaccurate the issuer must backup withhold 28% of the gross transactions of that business. Unfortunately, no specifics have been released as to how the IRS plans to work with credit and debit card companies to effectively implement these components of the proposal. There are likely to be reporting errors through this process of verifying TINs yet there is confusion regarding whether a small business owner must contact their credit card company or the IRS to address the problem.

In particular, small businesses should have a reasonable amount of time to correct any errors before backup withholding kicks in. The self-employed business owner typically handles all aspects of their business including tax compliance. They do not have the benefit of a team of accountants or administrative staff to assist them with compliance efforts.

Furthermore, in 2007 an NASE member's business had median gross revenue of \$62,500 and overwhelming their business was the main source of household income for their family. Withholding on gross transactions will create a substantial cash flow problem for the self-employed and could not only considerably harm their business, but could also place severe financial strain on their family. Thus, we must have a clear understanding of the verification process and back up withholding procedures outlined in this recommendation.

Cost Concerns

Overall implementation of this proposal will clearly require substantial financial and human capital resources by both the IRS and the credit/debit card companies. Questions abound regarding whether the IRS has the infrastructure to create a streamlined verification system and

can handle the volume of paperwork they will receive should this proposal be enacted. We think it is prudent for Congress to work with the IRS to prepare a cost/ benefit analysis of this proposal which would determine the potential costs of implementation and administration as it compares to projected revenue.

Moreover, credit and debit card companies are likely to pass on the cost of compliance to their micro-business merchants in the form of higher user fees. NASE member **Keith Kaufman** owns a small business in Camp Verde, Arizona that receives approximately 60 percent of its transactions through credit or debit cards. Keith is worried about the additional financial burden in the form of increased fees that this policy would place on his business. Because he cannot charge more for credit card transactions, he'd have to "eat" the additional charges which would hurt his bottom line. He feels he is "already taxed to death".

Increased fees will have a negative impact on revenues and sales of micro-business owners, forcing them to either minimize their acceptance of credit cards or increase prices of their goods/services. This could have significant consequences on our weakening economy. **Sondra Daggett**, an NASE member in Cedar Rapids, Iowa believes that the possibility of increased credit card fees that would stem from this recommendation will "wreak havoc with small retailers who are scraping to get by as it is."

We encourage the Committee to reach out to credit/debit card companies, banks and other pertinent parties to determine the ultimate financial impact on consumers before moving forward with this proposal.

Overall Effectiveness

In conclusion, there are two key questions related to overall effectiveness that need to be asked:

- Will this proposal increase tax compliance?
- Will the government recoup funds with the implementation of this proposal?

Addressing the first question, the majority of NASE's members feel that this recommendation will not increase tax compliance. They are quick to point out that this proposal will be collecting information that is likely already reported. The taxpayer who willingly underreports income would not knowingly choose to exclude credit card receipts since those items show up on their bank statements. Transactions via credit and debit cards are well documented and would be revealed upon review, so it is unlikely that those amounts would be a key source for intentional underreporting. Therefore, the NASE believes this approach will not be effective in increasing our current level of tax compliance.

As to the question of additional revenue recovered from actions taken as a result of implementing this recommendation, the NASE believes that it is highly unlikely this proposal

will identify any additional taxable income that would not have already been reported. We feel that any revenue collected would stem from inaccuracies or mistakes made during the Taxpayer Identification Number (TIN) verification process which would trigger the backup withholding mechanism suggested in this proposal.

The NASE proposes that increased information reporting on electronic payment transactions would have the opposite intended effect and actually increase costs for both the federal government, due to implementation and enforcement needs, and small business, due to enhanced fees associated with credit card usage. Furthermore, this recommendation may put the self-employed out of business and deter prospective entrepreneurs due to the likelihood that it will significantly add to the cost of starting up and running a business that requires credit and debit card transactions.

Final Thoughts

The National Association for the Self-Employed does not support the passage of this proposal and strongly urges Congress to consider alternate solutions to increase tax compliance. The focus of any balanced and effective policy to boost compliance should be on overall simplification, eliminating issues of inequity within the tax code, and enhancing taxpayer education and outreach.

Key elements of the tax gap are the underreporting of income and concern of the accuracy of cash payments reported on tax returns. The electronic payments tax reporting proposal does nothing to address these issues. The NASE has made recommendations to Congress and the IRS for simple changes to the tax code and tax forms that would assist in increasing documentation of revenue and lessening potential underreporting yet would have no significant negative impact on micro-business and the self-employed.

However, it is in our opinion that legislators' true interest in this proposal and others relating to the tax gap lies with its possible use as an offset for various congressional spending priorities. We understand that our government has bills to pay and services to maintain, however as one of our NASE members expressed to us, this proposal is simply "Robbing Peter to pay Paul." This is not the approach our government should be enlisting. You are asking the segment of our economy which is experiencing the most discomfort from high energy costs, high health care costs, and our credit crunch to foot the bill for various proposals. Many of which they will receive no benefit from.

Congress should focus ensuring passage of effective policy at a reasonable cost to **ALL** our citizens before they rush to put the financial squeeze on the self-employed and micro-businesses, which remain the foundation of both America's economy and communities.